Yardeni Research

December 15, 2025

Morning Briefing

Game Of Thrones: The Mag-7 & The Fed

Executive Summary: It has all the drama of “Game of Thrones”: The Magnificent-7 kingdoms have each been surrounded by moats and rarely threatened each other’s monopolies. Now, with the advent of AI, they have been encroaching on each other’s previously sacrosanct fiefdoms, forcing one another to spend ever more to remain in the game. Amid the chaotic disruption, investors’ AI euphoria has given way to AI agita as confidence in the Mag-7 ebbs. Are their earnings inflated by accounting? Will returns justify their capital investments? Our take: AI will have a powerful impact on productivity in the economy. The winners may not be among the Mag-7 at all but the S&P 500’s Impressive 493 and the economy at large. … Today, Dr Ed enlists the help of Google’s Gemini AI assistant to extend the “Game of Thrones” metaphor to this disruption as well as the transition in the Fed’s Iron Throne. ... Also: Dr Ed reviews “Task” (+).

YRI Weekly Webcast. Join Dr Ed’s live webcast with Q&A on Mondays at 11 a.m., EST. You will receive an email with the link one hour before showtime. Replays of the weekly webcasts are available *here*.

Game of Thrones I: AI Battles & the Roaring 2020s. Our “Roaring 2020s” narrative has been based on a technology-led productivity boom. Artificial intelligence (AI) was a minor part of our story back in 2020 when we developed our base case for the decade ahead. Little did we know that OpenAI would introduce ChatGPT in late 2022, thus becoming a major part of our story.

Our initial premise was that as the Baby Boomers retired, the labor force growth rate would slow. That would exacerbate the mismatch between workers’ skills—especially those of new, younger entrants to the labor force—and employers’ requirements. We concluded that employers would have no choice but to use technology to boost the productivity of their employees. AI boosted our story.

The productivity miracle promised by AI certainly helped to drive the stock market to new record highs this year. But in recent weeks, the market has climbed a wall of worry. Investors’ excitement over AI’s capabilities has given way to concerns about accounting

issues, earnings and credit quality, mounting competition, returns on invested capital, and the sustainability of the AI trade.

Investors no longer are asking what AI companies can build but whether they are overpaying for it—and whether expected returns will materialize before the hardware becomes obsolete. A case in point: The debate over depreciation schedules for graphics processing units (GPUs).

Critics, including some prominent bears like Michael Burry, have accused the hyperscalers of unduly aggressive accounting practices because they depreciate their AI chips over five or six years. The relentless pace of innovation, the bearish argument goes, renders these chips economically obsolete in just two or three years. Nvidia's shift to a one-year product cycle attests to that. If the useful life of a GPU is indeed half of what is being reported, then current earnings for the cloud giants are significantly overstated, and the massive capital expenditure boom is a ticking timebomb of future write-downs.

We side with the hyperscalers on this issue. The reality of the data center is a "value cascade." A three-year-old chip would still hold value even if it is no longer fit for training the most advanced frontier large language models (LLMs). It would likely be perfectly viable for inference tasks, which require less compute power but represent the bulk of long-term commercial demand. The hardware does not turn into scrap metal the moment a faster chip is released; it simply moves down the value chain.

For us, the big issue is competition. It has increased significantly in recent weeks for the Magnificent-7. They no longer have fortress monopolies in search (Google), software (Microsoft), online retailing (Amazon), advertising (Meta), electric vehicles (Tesla), smart phones (Apple), and GPU chips (Nvidia). These monopolies now are threatened by their fierce competition in the AI race. They are all scrambling to produce and to use state-of-the-art LLMs and processing chips. Their new AI capabilities directly threaten one another's monopolies in one way or another. That's forcing them to spend more on capital and labor to remain competitive in the AI race.

We view investors' recent anxieties as the "indigestion" phase of a massive technological adoption cycle rather than the end of the story. History teaches us that during major paradigm shifts, the market often oscillates between euphoria and skepticism regarding the timing of the payoff.

While questions about AI players' earnings quality and capex binge are valid, they do not

negate the underlying and more powerful productivity trend that AI will catalyze. We continue to believe that the integration of AI into the broader economy will boost productivity, subdue unit labor costs, and widen profit margins for S&P 500 companies, especially the "S&P 493" (i.e., all except the Mag-7) over the long haul. The risks are real, but so is the revolution.

For now, the stock market's path of least resistance remains higher, even if the ascent is becoming more volatile. We reiterate our recommendation for 2026: Overweight the S&P 500's Impressive 493 and underweight the S&P 500's Mag-7. The former benefit from the increasing competition among the latter.

Game of Thrones II: Mag-7s' Moats Are Drying Up. As noted above, beyond the accounting debates, a more fundamental uncertainty is the intensifying competition among the LLM providers and chip producers, a dynamic we have likened to "*Game of Thrones*."

In the early stages of the AI boom, the Magnificent-7—i.e., Apple, Microsoft, Amazon, Alphabet (Google), Nvidia, Meta Platforms (Facebook), and Tesla—seemed to operate in separate fiefdoms, each with its own impenetrable moat. Today, those moats are drying up as the giants attack each other's core businesses with their AI weapons.

It's a classic "*prisoner's dilemma*": Each company is forced to spend tens of billions on capex not just to grow but to avoid falling behind. This massive spending creates a short-term boost for the "pick and shovel" providers like Nvidia, but it raises uncomfortable questions about the eventual return on investment for the buyers. If LLMs become commoditized—a race to the bottom on price per token—then the profit margins implied by current stock valuations could be at risk.

I did not watch "Game of Thrones," so I turned to AI for help in extending this metaphor. Google's Gemini produced much of the following, showcasing its intelligence, creativity, insight, and quirks.

For much of the last decade, the Magnificent-7 operated like the Great Houses of Westeros during a long summer of peace, each ruling over a distinct and impregnable kingdom. Their fortresses, surrounded by deep moats, were secure. They didn't cross borders to invade one another's core territories. They were content to grow fat on their own monopolies, respecting a tacit treaty that allowed for high margins and separate spheres of influence.

The arrival of generative AI has acted as a catalyst for chaos among the Mag-7, effectively

drying up their moats and plunging the tech sector into a “War of the Seven Kings.” Borders no longer mattered. Every kingdom was vulnerable to invasion.

The initial aggressor in this new saga was Microsoft, which, by allying with OpenAI, effectively sent a dragon to attack the gates of Google’s search monopoly. For the first time in 20 years, the loyalty of the “Search Kingdom’s” subjects is being tested, as the chat interface threatens to replace the blue link. The counterattacks have been swift and brutal. We are witnessing a classic “chaos is a ladder” moment in which the disruption of the status quo enables new alliances to form and causes old hierarchies to crumble.

Perhaps the most fascinating subplot in this “Game of Thrones” is the uneasy relationship between the Great Houses and the Dragon Lady, Nvidia. Currently, Nvidia supplies the GPUs that every House needs to survive the winter. However, the other six kings are deeply uncomfortable with this dependency. Just as the Iron Bank eventually demands its due, Nvidia’s margins are a direct tax on the rest of the group. Consequently, Amazon, Google, and Microsoft are feverishly working to forge their own custom silicon, hoping to break Nvidia’s stranglehold on the realm’s weaponry. This is no longer a battle for expansion; it is an existential battle for sovereignty over a kingdom’s own infrastructure.

The Grand Maesters have begun to quarrel over the lifespan of the dragons themselves. These beasts—the great GPUs that breathe fire into the models—were thought to be immortal assets, their cost spread over many long winters to spare the treasury. But the pace of the old magic is too fast: A dragon born today is a lizard by tomorrow, outmatched by younger, fiercer breeds. If the House pays for a beast over five years, but it grows too weak to fight in three, then the House is bankrupt without even knowing it. The books are a deception, a shield of paper trying to hold back a sword of steel. “The Depreciation,” they call it, is a curse that turns assets to dust before they are fully paid for.

The moats are gone. The distinctive kingdoms have dissolved into a single, muddy battlefield. It is no longer enough to rule one domain; one must rule them all or perish. The War of the Seven Kings has begun, and the cost of the armies—the gold poured into the data centers and the training runs—threatens to bankrupt the realm. In this new game, there is no middle ground: You either win the AI Iron Throne or you die.

Ultimately, this internecine warfare implies a substantial increase in the cost of governance. The “peace dividend” of the last decade—the ability of these companies to return billions to shareholders via buybacks while spending moderately on R&D and capital infrastructure—is over. We are entering a period of heavy “war spending” (capex), where the Magnificent-7

must burn through their treasuries to stay in the game. While this will compress their profit margins, history suggests that such intense competition usually benefits the broader realm—the economy. As the clash of the titans forces them to slash prices and race to deploy the most powerful tools to win the throne, the productivity benefits will cascade down to the rest of the S&P 500, keeping our “Roaring 2020s” scenario very much alive, even as the kings bleed.

Game of Thrones III: Fed’s Iron Throne Is Up for Grabs. According to Fed Chair Jerome Powell, tariffs have caused inflation to stall at around 3.0% y/y. However, this is likely a transitory problem. If so, inflation should resume its decline toward the Fed’s 2.0% inflation target over the next couple of years. Powell said so in his *press conference* last Wednesday.

Another dovish observation Powell made was that the average 40,000 increase in payroll employment from April through September might be overstated by 60,000, implying that employment fell by 20,000 per month on average. Yet Powell also marveled at the economy's strength, attributing it to productivity—a hawkish observation.

Powell acknowledged that at last week’s FOMC meeting, the 19 participants were extremely divided on the economic outlook and on whether the latest rate cut was necessary—more so than ever during his watch as Fed chair. Maybe he commands less unanimity than in the past because he relinquishes his seat on the Fed’s Iron Throne on May 15, 2026.

Movie. “Task” (+) is a mildly entertaining 2025 HBO limited series. The show centers on Tom Brandis (Mark Ruffalo), a grief-stricken former priest turned FBI agent, who leads a task force hunting a crew of sanitation workers robbing drug dens—a crew led by a desperate family man (Tom Pelphrey) seeking vengeance for his brother. Just about every character is miserable for one reason or another. Lots of them die for one reason or another. But the cast of characters provides solid performances, while they remain alive. (See our movie reviews *archive*.)

Strategy Indicators

Global Stock Markets (US$ Performance) (*link*): The US MSCI index dropped 0.7% during the December 12 week to 1.1% below its record high on October 28. The AC World ex-US outperformed, with a 0.7% gain for the week to less than 0.1% below its record high on October 29. The AC World ex-US has been hitting new record highs since May 14—the

first time it's had such a long streak of successive record highs since June 15, 2021. EMEA was the best performing region last week, with a gain of 1.8%, followed by EM Latin America (1.2%), EAFE (0.9), EMU (0.7), and the AC World ex-US. EM Asia was unchanged for the week, but was the worst regional performer, followed by EM (0.3) and Europe (0.7). The Mexico MSCI index, with a gain of 2.5%, performed the best among country indexes, ahead of South Africa (1.8), Spain (1.7), Sweden (1.6), and Germany (1.6). The India MSCI index was the worst performer w/w, with a decline of 0.9%, followed by China (-0.7), the USA (-0.7), the UK (-0.2), and Brazil (0.1). In terms of ytd performance rankings, the 16.8% gain for the US MSCI index ranks as the third worst country performer and trails the 26.8% gain for the AC World ex-US. Among the regional indexes outperforming the AC World ex-US ytd, EM Latin America leads with a gain of 45.9%, followed by EMU (33.7), EM (28.8), EM Asia (28.3), Europe (28.1), and the AC World ex-US. EMEA is the worst ytd performer, albeit with a gain of 23.5%, followed by EAFE (25.2). Korea is the best ytd performer, with a gain of 83.4%, followed by Spain (69.4), South Africa (62.8), Mexico (46.4), and Brazil (42.1). The worst performing countries ytd: India (2.8), Australia (9.5), the US (16.8), Japan (22.0), and France (23.4).

US Stock Indexes (*link*): Thirty-one of the 48 major US stock indexes that we follow rose during the week ended December 12, compared to 41 rising a week earlier and all 48 the week before that. The S&P 500 LargeCap Pure Value index was the best performer for the week, with a gain of 2.9%, ahead of S&P 600 SmallCap Value (2.4), S&P 600 SmallCap Pure Growth (2.2), S&P 600 SmallCap (2.0), and S&P 600 SmallCap Equal Weighted (2.0). The Nasdaq 100 index was the worst performer, with a decline of 1.9%, followed by S&P 500 LargeCap Growth (-1.7), Nasdaq Composite (-1.6), Russell 1000 Growth (-1.6), and Russell 3000 Growth (-1.5). All 48 indexes are still higher ytd. With a gain of 20.5%, the S&P 500 LargeCap Growth index remains in the top spot as the best performer so far in 2025, ahead of Nasdaq Composite (20.1), Nasdaq 100 (19.9), S&P 100 MegaCap (18.2), and S&P Industrials Composite (16.5). The worst performing major US stock indexes ytd: S&P 600 SmallCap Equal Weighted (5.5), Nasdaq Industrials (5.8), S&P 600 SmallCap (7.2), S&P 600 SmallCap Growth (7.3), S&P 400 MidCap (7.4), and S&P 600 SmallCap Value (7.4).

S&P 500 Sectors Performance (*link*): Six of the 11 S&P 500 sectors rose during the week ended December 12, and seven were ahead of the S&P 500's 0.6% decline. That compares to six S&P 500 sectors rising a week earlier, when the same six were ahead of the S&P 500's 0.3% gain. The outperformers last week: Materials (2.4%), Financials (2.3), Industrials (1.4), Consumer Staples (1.1), Health Care (0.4), Consumer Discretionary (0.3), and Energy (-0.6). The underperformers last week: Communication Services (-3.2), Information

Technology (-2.3), Utilities (-1.1), and Real Estate (-0.8). The S&P 500 is now up 16.1% ytd, with all 11 sectors positive ytd and three are ahead of the index. During the June 20 week, Consumer Discretionary and Health Care were trailing so far behind ytd that they were the only sectors trailing the index. Communication Services remains the best ytd performer with a gain of 30.6%, followed by Information Technology (22.5) and Industrials (18.6). These eight sectors are lagging the S&P 500 so far in 2025: Real Estate (0.1), Consumer Staples (3.0), Energy (5.7), Consumer Discretionary (5.8), Materials (7.2), Health Care (11.6), Utilities (12.3), and Financials (13.3).

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